Sanlam

Legal Report

May 2024

1. Requirements for rule amendments in respect of the Two-pot system

The Financial Sector Conduct Authority (FSCA) in February 2024 issued FSCA Communication 3 of 2024 (RF), in which they set out the FSCA's requirements for rule amendments in respect of the Two-pot system. Following the publication of this Communication, there have been changes to the Two-pot legislation and engagements with the industry, which required the withdrawal of the Communication and the issuing of a new Communication. The FSCA has accordingly on 30 April 2024 issued FSCA Communication 16 of 2024 (RF) ("the Communication"), the purpose of which is to set out the FSCA's revised requirements regarding two pot rule amendments and to outline the approach that the FSCA will be taking towards applications for such amendments.

The Communication mostly sets out the relevant legislative provisions with regard to the Two-pot system, which must be set out in the rules of retirement funds. In addition, in other words apart from that which must be included in the rules in terms of the amendments to the Income Tax Act and the Pension Funds Act, the Communication also requires fund rules to deal with the following:

- From 1 September 2024, on liquidation of a fund, members may only access their retirement component on their retirement date. On liquidation the retirement component needs to be transferred to an approved retirement fund. Funds are required to amend their rules to deal with liquidations.

- The Communication clearly sets out what should be contained in the rules of defined benefit funds to make provision for the Two-pot system. Should the fund wish to adopt a different methodology than that set out in the Communication, this must be approved by the FSCA in advance, whereafter the methodology must be clearly set out in the rules.

- The rules will need to provide that deductions in terms of section 37D of the Pension Funds Act will be effected proportionately across the three components, i.e. the vested, retirement and savings components.

- The rules of the fund must provide how benefits will be impacted when a member ceases to be a tax resident for an uninterrupted period of 3 years or departs from South Africa at the expiry of a work or visit visa.

- The total retirement contributions for the purposes of allocating to the respective components must be described as any amount contributed to a fund by or on behalf of a member on or after 1 September 2024 after the deduction of any charges and risk premiums.

Member Communication

- Retirements funds are expected to communicate the proposed legislative changes to members in a manner which is simple, clear, and comprehensive and such communication must be timely and on-going.

- The communication should, inter alia, alert members to the impact that any withdrawal from the savings component will have on the value of the member's benefit. This can be done by way of illustration, using examples.

- Member communication must be clear that marginal tax rates are applicable to savings withdrawal benefits before retirement.

- The FSCA may request a copy of the communication issued by or on behalf of the fund to the members of the fund.

Submission of Two - pot rule amendments

- In the interest of the FSCA considering applications for amendments expeditiously, it is requested that all rule amendments in respect of the Two-pot system should be limited to the rule amendments set out in the Communication. No other rule changes are to form part of such rule amendment submissions.

- Funds and/or administrators may commence submitting two pot rule amendments from 2 May 2024 until 15 July 2024 to enable the FSCA to process and approve them timeously before the 1 September 2024 deadline. These rule amendment submissions will be processed on a first-come-first-serve basis and any submissions made after 15 July 2024 will only be processed once the first batch has been completed.

2. Amendments to conduct standard on section 14 transfers

The Financial Sector Conduct Authority (FSCA) has published draft amendments to the conduct standard on section 14 transfers, FSRA Conduct Standard 1 of 2019 (PFA). The reason for the amendments are explained as follows in the Communication accompanying the amendments:

"*The Minister of Finance is in the process of finalising amendments to Regulations under the PFA to give effect to the so-called Two-Pot system. The aforementioned amendments will result in misalignment between the current prescribed section 14 application forms and the Two Pot Regulations, as the current section 14 application forms do*

not provide allowance for the transfer value in relation to the two-pot system. The section 14 application forms only allow for a single transfer value, whereas the implementation of the Two Pot Regulations will require the transfer value to be differentiated in two parts in the forms. As such the section 14 application forms will have to be revised."

The proposed amendments entail that all the various section 14 transfer forms are removed from the conduct standard, and that the FSCA is empowered to determine the content and format of the forms by way of publication on its website.

The revised forms have not yet been published. In this regard, the following is said in the Communication accompanying the amendments:

"*It is important to note that the amendments to the revised section 14 application forms will be consulted on separately to the necessary legislative amendment and as a parallel process, to avoid any delays in consultation on the proposed legislative change.*"

Comments can be provided on the draft amendments until 19 June 2024.

3. National Health Insurance Act

The National Health Insurance Act ("the Act"), which has been the subject of intense debate over the last couple of years, was published in the Government Gazette on 16 May 2024. The Act makes provision for the establishment of a National Health Insurance Fund which will purchase health care services on behalf of South Africans. From a medical scheme perspective the most important provision in the Act is section 33, which reads as follows:

"*Once National Health Insurance has been fully implemented as determined by the Minister through regulations in the Gazette, medical schemes may only offer complementary cover to services not reimbursable by the Fund.*"

The above means that once national health insurance has been fully implemented, medical schemes will only be able to provide cover in respect of medical services not covered by the National Health Insurance Fund. The constitutionality of the Act, and of the above provision in particular, has been called into question by various sectors, and several institutions have indicated that they will challenge the constitutionality of the Act in court. Concerns have also been expressed about the affordability and practical implementability of a national health insurance system.

Even if the Act survives the challenges to its constitutionality, the implementation of the system will take several years to implement as the National Health Insurance Fund must still be established and the detail regarding the operation of the system must still be deliberated on. Medical schemes will accordingly for the foreseeable future remain unaffected by the Act, and members of these schemes will continue to enjoy the benefits that they currently do. If the operation of medical schemes is impacted, this will only happen in a number of years and it is at this stage not yet clear what exactly such impact will be.

4. Recognition of Muslim marriages

The Constitutional Court case of *Women's Legal Centre Trust v President of the Republic of South Africa and Others* [2022] ZACC 23 recognised the need for, and importance of, protecting Muslim women and children of Muslim marriages, particularly in the instance of the dissolution of a Muslim marriage. The case held that the Divorce Act was unconstitutional to the extent that it failed to recognise Muslim marriages which have not been registered as civil marriages, as valid marriages. The Constitutional Court ordered the President and Parliament to amend the Divorce Act, or to pass new legislation to remedy the defects in the Divorce Act, to ensure the recognition of Muslim marriages.

On 9 May 2024, President Ramaphosa signed the Divorce Amendment Bill into law. Previously, Muslim couples who chose to marry according to Islamic law could only be afforded the statutory protection of the South African legal system as it pertained to civil spouses if they, in addition to their marriage under Islamic law, registered a civil marriage. The amended legislation addresses these shortcomings in the Divorce Act.

The amendments to the Divorce Act, as per the Divorce Amendment Act, are as follows:

- A definition of a Muslim marriage has been included. In terms of this definition a Muslim marriage is a marriage entered into or concluded in accordance with the tenets of Islam.
- A Muslim marriage may now be dissolved by a court.
- Provision has been made for the safeguarding of interests of dependent and minor children of a Muslim marriage. This relates to issues of maintenance, custody, guardianship and access to a minor child of a Muslim marriage.
- Provision has been made for the redistribution of assets on the dissolution of a Muslim marriage as well as the forfeiture of patrimonial benefits of a Muslim marriage. The factors that a court must take into consideration when making a redistribution order have also been extended to include any contract or agreement between the parties in a Muslim marriage where the husband is a spouse in more than one Muslim marriage.
- An order for the forfeiture of patrimonial benefits has been extended to apply to Muslim marriages.

The Divorce Amendment Act applies to all existing Muslim marriages, including those –

- which were dissolved in accordance with the tenets of Islam and where the legal proceedings for the dissolution of the Muslim marriage in terms of the Divorce Act have been instituted but not yet finalised; and
- which existed as at 15 December 2014.

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The Divorce Amendment Act is welcomed as it will ensure the recognition of Muslim marriages as valid marriages for the purpose of regulating the consequences of the dissolution of a marriage as provided for in the Divorce Act. From a retirement fund perspective the most important implication of the amendments is that a pension interest allocation is now also possible in the case of a Muslim marriage which has been dissolved by a court.

5. Joint Standard on Cybersecurity and Cyber Resilience Requirements

Introduction

The Prudential Authority (PA) and the Financial Sector Conduct Authority (FSCA), hereinafter jointly referred to as "the Authorities", on 16 May 2024 published Joint Standard 2 of 2024 on Cybersecurity and Cyber Resilience Requirements for Financial Institutions. The Joint Standard applies to various financial institutions, whereunder insurers, retirement funds and retirement fund administrators. It sets out detailed requirements and principles for sound practices and processes relating to cybersecurity and cyber resilience.

Background

The rise of the digital era has transformed how financial institutions interact with their clients. While technological advancement has brought with it numerous benefits, the threat landscape has also evolved.

Cyber-attacks are often targeted at strategic industry sectors such as the financial sector. There is therefore a need for the Authorities to provide an appropriate and comprehensive regulatory framework for managing cyber risks from both a prudential and conduct perspective.

The requirements

The Joint Standard aims to ensure that financial institutions establish sound and robust processes for managing cyber risks and promote the adoption of cybersecurity fundamentals and hygiene practices to preserve confidentiality, integrity and availability of data and IT systems.

It sets out detailed principles that financial institutions must comply with, including, but not limited, to:

- establishing and maintaining a cybersecurity strategy that is aligned with their overall business strategy and that is reviewed at least annually;
- implementing cyber resilience capabilities and practices to prevent, limit and/or contain the impact of a potential cyber event or cyber incident;

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- installing network security devices to secure the network;
- establishing a comprehensive cybersecurity awareness training programme;
- monitoring and detecting cyber events and cyber incidents;
- implementing an incident response and management plan;
- testing control effectiveness;
- conducting regular vulnerability assessments on their IT systems; and
- implementing malware protection.

A financial institution must further notify the responsible authority of the following, after classifying it as a material incident:

- cyber incidents;
- information security compromise.

"Material incident" is defined as "*a disruption of a business activity, process or function which has, or is likely to have, a severe and widespread impact on the financial institution's operations, services to its customers, or the broader financial system and economy*".

Regarding the effective date of the Joint Standard, the following is said in the Communication accompanying the Standard:

"*The Joint Standard is envisaged to commence on 1 June 2025. Notwithstanding the fact that the Joint Standard will likely take effect after 12 months, the Authorities urge the industry to prepare for its implementation. The Authorities will, as contemplated in paragraph 10.1 of the Joint Standard, formally determine the effective date in due course.*"

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6. Joint Standard on Outsourcing by Insurers

The Prudential Authority (PA) and the Financial Sector Conduct Authority (FSCA) have published Joint Standard 1 of 2024 on Outsourcing by Insurers, which will come into operation on 1 December 2024.

The Joint Standard will replace Prudential Standard GOI 5, which currently regulates outsourcing by insurers. The rationale behind replacing Prudential Standard GOI 5 with a Joint Standard is as follows.

As Prudential Standard GOI 5 was issued by the PA, the outsourcing by insurers currently falls within the regulatory scope of the PA. This results in a gap from a conduct of business perspective as the PA is only responsible for the prudential supervision of insurers, with the conduct supervision of insurers falling under the FSCA.

There in view of the above is a need to expand the current outsourcing regulatory framework beyond Prudential Standard GOI 5, in order to provide an appropriate and comprehensive regulatory framework governing outsourcing by insurers from both a prudential and conduct perspective. The Joint Standard is therefore intended to harmonise the outsourcing requirements for the insurance sector, and enhance oversight by the PA and the FSCA.

According to the statement accompanying the Joint Standard, the Joint Standard is intended to address the following:

- set out minimum requirements for the outsourcing of material functions;
- set out the concept of "materiality" in the business of the insurer;
- set out the conditions that determine when an outsourcing arrangement requires prior regulatory notification;
- set out matters that an insurer must consider prior to an outsourcing decision and legal provisions that must be included in any outsourcing contract;
- set out requirements for the management and review of outsourcing arrangements;
- require insurers to have a board-approved policy and related procedures for assessing the risks involved with outsourcing; and
- repeal and replace Prudential Standard GOI 5.

The requirements as set out in the Joint Standard are substantially similar to those currently contained in Prudential Standard GOI 5. There are however a few important changes, whereunder the following:

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- An insurer must, in order to identify and manage all risks that may be introduced by an outsourcing arrangement, undertake an appropriate due diligence for every activity or function to be outsourced, prior to entering into an outsourcing arrangement.

- When terminating any material outsourcing arrangement, an insurer must assess the potential impact, consequences and risks of the proposed termination to policyholders and the insurer's business, and report thereon to its board of directors.

- The notice of termination of an outsourcing arrangement which is required to be submitted to the PA and the FSCA, must inter alia:

  - include proof that the insurer approved the termination;

  - explain whether there are any outstanding issues that could have a potential impact on the service to policyholders and how these issues will be managed to ensure policyholders are not adversely affected; and

  - highlight any outstanding fees and how such fees will be paid.

The following transitional provisions will apply:

- an insurer must comply with the Joint Standard within 6 months from the commencement date thereof, in other words within 6 months of 1 December 2024, during which period it must continue to comply with Prudential Standard GOI 5;

- any outsourcing arrangement entered into prior to the commencement date must comply with the Joint Standard within 24 months from 1 December 2024, or upon renewal or renegotiation of the outsourcing arrangement, whichever comes first.

Retirement funds or other clients requiring more information should not hesitate to contact their consultant.

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